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SUBJECT: SAVING MALPENSA - THE AIRPORT AFTER ALITALIA

REF: 06 ROME 3330

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Summary

¶1. (SBU) Alitalia's cost-cutting rescue plan includes deep cuts in service to and from Milan's Malpensa airport, primarily decreasing intercontinental flights. The Lombardy Region (home to Malpensa airport) fears these cuts will change Malpensa from a European hub to regional airport, dooming area businessmen to an extra connection through London, Paris or Frankfurt for long haul flights. Despite pleas from the Regional President, Alitalia will go ahead with the cuts. The Region is looking past substantial offers from short-trip, low-cost carriers to try to recruit a carrier to provide long-haul, intercontinental service. The Region is keenly interested in increased service from U.S. airlines and U.S. investment in a new Italian carrier. With major players waiting to see the fate of Alitalia, the Region is unlikely to find a quick replacement for Alitalia's abandoned routes at Malpensa. End summary.

The Problem - Disappearing Destinations

¶2. (SBU) After the recent disintegration of privatization talks, Alitalia proposed a rescue plan to cut its 450 million euro annual operating loss. By cutting more than 150 flights from Malpensa and refocusing on Rome's Fiumicino as its sole hub, Alitalia would save approximately 200 million euro. Alitalia proposes recovering the other 250 million euro through increased efficiency and reductions in baggage handling and personnel costs. (Note: Previous attempts to reduce personnel costs were stymied by the unions. End note.) Alitalia has not announced which specific flights will be cut. According to the Lombardy Region, Alitalia will primarily cut intercontinental routes, eliminating 14 out of 17 of Alitalia's intercontinental (international, non-European) destinations. The Region fears that Alitalia will pass its vacated slots to Alitalia-controlled low-cost carrier VolareGroup (VolareWeb and Air Europe) for national flights, effectively replacing Milan-Tokyo flights with

Milan-Palermo flights. The Region speculates that this rescue plan is geared towards the eventual purchase of Alitalia by a European carrier, such as Air France. By reducing the intercontinental flights from Malpensa, Milan traffic could be rerouted to another European hub such as Paris for intercontinental flights. The Region sees Malpensa as a major intercontinental hub for Europe, ranking behind only London, Paris and Frankfurt in number of intercontinental destinations. The loss of Alitalia's intercontinental service would reduce Malpensa to regional airport status.

The Region Steps In

¶3. (SBU) On September 18, the Lombardy Regional Council overwhelmingly approved a proposal to empower the Regional President Formigoni to engage the central government on the status of Malpensa. The proposal asked the GOI to reconsider the Alitalia rescue plan. It also called for Formigoni to participate in GOI Cabinet meetings related to Alitalia, to have a say in the distribution of Alitalia-vacated slots at Malpensa, and to actively engage other carriers in negotiations to increase service at Malpensa. Both center-right and center-left delegates joined to pass the proposal with the exception of the Northern League (Northern Italy-based, far-right secessionist party) members. (Comment: This rare show of bipartisan support between the center-right and center-left delegates illustrates the pragmatic character of Northern Italy politicians. Where there is an overriding community concern, local politicians in Northern Italy can come together to "get it done" despite acrimony between the parties at the national level. End comment.)

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¶4. (SBU) Lombardy Region President Formigoni and Regional Transportation Commissioner Cattaneo met with Alitalia Managing Director Prato on September 19. Lombardy officials asked Alitalia to maintain the intercontinental flights at Malpensa until other airlines can be found to fill slots that would be vacated by Alitalia or until Alitalia is sold. Formigoni argued that the cuts at Malpensa would save money in the short-term, but would ultimately be lost revenue in any sale of Alitalia as slots at Malpensa are valuable to prospective buyers. Alitalia replied that they would move forward with the cuts, announcing specific flight cancellations within two weeks. Formigoni cited press reports indicating that Alitalia would hold its slots even though the flights were canceled and asked Alitalia to pull out decisively so Malpensa could seek new service. Prato agreed not to resist the reassignment of its slots to other airlines but noted that the slots would be taken by whichever airlines request them (i.e. slots will not be held for similar services; slots vacated by intercontinental service cancellations would be available for domestic or intra-European flights and vice versa). The Region is reviewing Italian and EU law to find grounds to sue to keep slots open for intercontinental service.

Prospects for New Service

¶5. (U) RyanAir and EasyJet both offered to drastically increase their service into and out of Malpensa. RyanAir would invest almost USD one billion to add eighty flights. EasyJet would likewise increase service worth 600 million euro and add more than 200 jobs. Still, both carriers work on the low-cost business model, generally limiting service to flights of two hours or less. Other private Italian airlines such as Air One and Blue Panorama are reportedly interested, but these are small and service primarily

tourist destinations. None would replace the full range of intercontinental service for business travelers provided by Alitalia.

Keen Interest in U.S. Investment

¶6. (SBU) The Lombardy Region is keenly interested in U.S. investment in Malpensa. Regional Transportation Commissioner Cattaneo asked the Consulate to help identify U.S. airlines interested in increased service from Malpensa and U.S. investors interested in a partnership with Italian investors to form a new Italian airline to operate intercontinental service. The Region would be pleased if U.S. carriers took over dropped Alitalia service to the U.S., but emphasized that the most critical loss would be service to intercontinental destinations only operated currently by Alitalia. Hence, the Region is looking to replace direct service to destinations such as China, India and Brazil. While the Region understands these routes could not be directly operated by U.S. carriers, they hope U.S. investors might be interested in funding an Italian airline that could reach those destinations.

Background - Malpensa Market

¶7. (U) To bolster its efforts to preserve Malpensa as an international hub, the Region solicited economic analyses on Malpensa's market from Bocconi University and other economic research institutes. In 2006, Malpensa served 21.67 million passengers, 86 percent heading to international destinations. 70 percent of business travelers on Alitalia flights originated from Malpensa. One study likened Malpensa's service area to London's, citing major cities such as Turin and Genoa within easy transit distance to the airport. Further, infrastructure upgrades from now to 2015 will increase public transportation access, including a high-speed rail connection with Turin. The Milan Chamber of Commerce calculated that the withdrawal of Alitalia from Malpensa would result in 800,000 fewer tourists (or 540 million

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euros of lost tourism revenue). A report by the Ambrosetti group calculated that the withdrawal would cost area businesses 1.3 billion euro, calculating that on average 3 million business travelers would each have five hours of additional travel time (flight connections and layovers) for intercontinental destinations at an average of 85 euros per hour.

Comment - The Future of Malpensa

¶8. (SBU) The future of Malpensa will ultimately depend on whoever takes over Alitalia. If Air France or Lufthansa (the two favorites in press speculation) buys Alitalia, Malpensa is likely to become a feeder for Paris or Frankfurt with increased service from low-cost carriers to other European destinations. If an institutional investor (such as the Texas Pacific Group - a bidder in the previous round of Alitalia privatization negotiations) takes over, a revamped Alitalia could possibly restart intercontinental service from Milan to capture the business travel market. In either case, major airlines will likely wait to see what happens to Alitalia before significantly increasing service at Malpensa. The Region is unlikely to find a quick fix to replace the lost Alitalia intercontinental service. End comment.

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